Ketua Pengarah Hasil Dalam Negeri v Perbadanan Kemajuan Ekonomi Negeri Johor

COURT OF APPEAL (PUTRAJAYA) — CIVIL APPEAL NO J-01–61 OF 2002
LOW HOP BING, MOHD GHAZALI AND VINCENT NG JJCA
10 APRIL 2009

Revenue Law — Income tax — Assessment — Appeal against — Gifts of money to government — Deductions from taxpayer's non-exempt dividend income — Director General of Inland Revenue allowed deductions — Apportionment formula and apportioned deductions between taxpayer's non-exempt dividend income and exempt business income applied — Whether lawful and applicable — Whether word 'income' meant gross income or chargeable income — Whether exemptions of income tax to be given at gross income level or chargeable income level — Whether appellate intervention justified — Income Tax Act 1967 s 127(5)

The respondent ('the taxpayer') was a statutory body incorporated under the Johor State Enactment 1968 and its principal activities were to develop land for industrial, agricultural, property, mining, logging and other corporate activities. The taxpayer had two sources of income viz business and dividend. The Minister of Finance, in exercising the powers under s 127 of the Income Tax Act 1967 ('the Act'), granted the taxpayer the following exemptions from payment of taxes: (i) all income for the year of assessment 1980 to 1990; (ii) all income except dividend income and development tax for the year of assessment 1991; and (iii) all income except dividend income and development tax for the year of assessment 1992 to 1996. The instant appeal concerned the exemptions for only two years of assessment viz 1991 and 1992. In 1990 and 1991, the taxpayer made gifts of money to the State Government of Johor and claimed deductions for them from the taxpayer's non-exempt dividend income. Although the Director General of Inland Revenue ('DGIR') had, under s 44(6) of the Act, allowed the deductions claimed by the taxpayer, the DGIR had applied an apportionment formula and apportioned the deductions between the taxpayer's non-exempt dividend income and the exempt business income. Consequently, the DGIR issued two notices of assessment, both dated 20 November 1995, and raised assessments on the taxpayer as follows: (i) year of assessment 1991, tax payable was RM2,824,507.62; and (ii) for 1992, tax payable was RM1,978,744.94. The Special Commissioners of Income Tax had on the taxpayer's appeal revised the two notices of assessment, and the High Court

had affirmed the Special Commissioners' deciding order. Hence this appeal. In the instant appeal, the parties raised three questions for the court's determination. The first question was whether the word 'income' in s 127(5) of the Act meant gross income or chargeable income. The second question was whether the exemptions of payment of income tax were to be given at the gross income level or the chargeable income level. The third question was whether the DGIR's apportionment formula was lawful and applicable.

Held, allowing the appeal with costs:

(1) An exemption from tax should legally be deducted or claimed from the chargeable income and not the gross income. This was because the gross income per se may or may not be eligible to tax at all. When no tax is eligible, there is no question or necessity for the taxpayer to utilise or claim the exemption. In other words, where there is no income, there can be no liability to tax, in which case no question of exemption can ever arise. Thus, exemption is only relevant when there is chargeable income, but not otherwise (see paras 23–24).

(2) Applying the apportionment formula in *Ketua Pengarah Hasil Dalam Negeri v Daya Leasing Sdn Bhd* [2005] 4 MLJ 138 ('*Daya Leasing*'), to the instant appeal, the DGIR's apportionment of the deduction for the gifts of money between the taxpayer's non-exempt dividend income and the exempt business income was justified and lawful (see para 31).

(3) Gifts of money made to the State Government of Johor and claimed by the taxpayer as deductions under s 44(6) of the Act were apportioned accordingly. The total amount of the gifts claimed by the taxpayer could not be allowed against only one source of income when the aggregate income of the taxpayer consisted of the business income source and the dividend income source. The apportionment formula used by the DGIR was completely consistent with the approach adopted and recognised by this court in *Daya Leasing* (see para 31).

[Bahasa Malaysia summary

Responden ('pembayar cukai') merupakan badan berkanun yang diperbadankan di bawah Enakmen Negeri Johor 1968 dan aktiviti-aktiviti pembayar cukai yang utama ialah untuk membangunkan tanah bagi tujuan perindustrian, harta, perlombongan, pembalakan dan aktiviti-aktiviti korporat yang lainnya. Pembayar cukai mempunyai dua sumber pendapatan iaitu perniagaan dan dividen. Menteri Kewangan, dalam menjalankan kuasanya di bawah s 127 Akta Cukai Pendapatan 1967 ('Akta'), memberikan pembayar cukai pengecualian daripada pembayaran cukai seperti berikut: (i) semua pendapatan bagi tahun taksiran 1980 hingga 1990; (ii) semua

pendapatan kecuali pendapatan dividen dan cukai pembangunan bagi tahun taksiran 1991; dan (iii) semua pendapatan kecuali dividen pendapatan dan cukai pembangunan bagi tahun taksiran 1992 hingga 1996. Rayuan yang dikemukakan hanya berkenaan pengecualian bagi dua tahun taksiran iaitu 1991 dan 1992. Pada 1990 dan 1991, pembayar cukai membuat pemberian wang kepada Kerajaan Negeri Johor dan menuntut pemotongan bagi pihak mereka daripada dividen pendapatan pembayar cukai tak-kecuali. Walaupun Ketua Pengarah Lembaga Hasil ('KPLH'), di bawah s 44(6) Akta, telah membenarkan pemotongan seperti yang dinyatakan oleh pembayar cukai, KPLH telah memakai satu formula pembahagian dan membahagikan pemotongan antara dividen pendapatan tak-kecuali pembayar cukai dan pendapatan kecuali perniagaan. Oleh itu, KPLH mengeluarkan dua notis taksiran, kedua-duanya bertarikh 20 November 1995, dan menaikkan taksiran-taksiran ke atas pembayar cukai seperti berikut: (i) tahun taksiran 1991, cukai dibayar ialah RM2,824,507.62; dan (ii) untuk 1992, cukai dibayar ialah RM1,978,744.94. Pesuruhjaya Khas Cukai Pendapatan telah menyemak dua notis taksiran atas rayuan pembayar cukai, dan Mahkamah Tinggi telah mengesahkan perintah pemutus Pesuruhjaya Khas tersebut. Maka perayu merayu. Dalam rayuan ini, pihak tersebut telah mengemukakan tiga soalan untuk ditentukan oleh mahkamah. Soalan pertama sama ada perkataan 'income' dalam s 127(5) Akta bermaksud pendapatan kasar atau pendapatan tercukai. Soalan kedua ialah sama ada pengecualian bayaran cukai pendapatan akan diberikan pada peringkat pendapatan kasar atau peringkat pendapatan tercukai. Soalan ketiga ialah sama ada formula KPLH sah dan boleh digunapakai.

Diputuskan, membenarkan rayuan dengan kos:

(1) Pengecualian daripada cukai perlu dipotong secara sah atau dituntut daripada pendapatan boleh cukai dan bukannya pendapatan kasar. Ini kerana pendapatan kasar *per se* mungkin layak atau tidak untuk dikenakan cukai sama sekali. Apabila tiada cukai layak dikenakan, maka tiada soalan atau keperluan bagi pembayar cukai untuk menggunakan atau menuntut pengecualian. Dalam perkataan lainnya, apabila tiada pendapatan, maka tiada liabiliti untuk dikenakan cukai, dan tiada soalan mengenai pengecualian akan timbul dalam kes sebegini. Oleh itu, pengecualian hanya relevan apabila terdapat pendapatan boleh cukai, bukan sebaliknya (lihat perenggan 23–24).

(2) Dengan menggunakan formula pembahagian dalam *Ketua Pengarah Hasil Dalam Negeri v Daya Leasing Sdn Bhd* [2005] 4 MLJ 138 ('*Daya Leasing*'), kepada rayuan ini, pembahagian KPLH bagi potongan untuk

pemberian wang di antara pendapatan dividen tak-kecuali pembayar cukai dan pendapatan kecuali perniagaan adalah betul dan sah (lihat perenggan 31).

(3) Pemberian wang yang dibuat kepada Kerajaan Negeri Johor dan dituntut oleh pembayar cukai sebagai potongan di bawah s 44(6) Akta dibahagikan sewajarnya. Jumlah keseluruhan pemberian yang dituntut oleh pembayar cukai tidak boleh dibenarkan terhadap hanya satu sumber pendapatan apabila pendapatan agregat pembayar cukai adalah termasuk sumber pendapatan perniagaan dan sumber pendapatan dividen. Formula pembahagian yang digunakan oleh KPLH secara keseluruhannya konsisten dengan pendekatan yang diambil dan diakui oleh mahkamah ini dalam *Daya Leasing* (lihat perenggan 31).]

Notes

For cases on assessment of income tax, see 10 *Mallal's Digest* (4th Ed, 2008 Reissue) paras 2167–2202.

Cases referred to

Ketua Pengarah Hasil Dalam Negeri v Daya Leasing Sdn Bhd [2005] 4 MLJ 138; [2005] 2 CLJ 449, CA (folld)

Ketua Pengarah Hasil Dalam Negeri v MCI Society Ltd (2000) MSTC 3792, CA (refd)

London County Council v AG [1901] AC 26 (refd)

Lower Perak Co-operative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri [1994] 2 MLJ 713, SC (folld)

MCI Society Ltd v Ketua Pengarah Hasil Dalam Negeri (1995) MSTC 2272 (refd)

Raja's Commercial College v Gian Singh & Co Ltd [1976] 2 MLJ 41, PC (refd)

Legislation referred to

Income Tax Act 1967 ss 2(2), 5, 33(1), 44(6), 127, 127(5)

Income Tax (Leasing) Regulations 1986

Johor State Economic Development Corporation Enactment (No 4 of 1968)

Appeal from: Civil Appeal No 14–01 of 1999 (High Court, Kuala Lumpur)

Hazlina bt Hussain (Mohd Harris bin Hanapi and Zaleha bt Adam with her) (Legal Officers, Inland Revenue Board) for the appellant.

Md Ali bin Zaitun (Kunasegaran with him) (Ali Zaitun & Baharudin) for the respondent.

Low Hop Bing JCA (delivering judgment of the court):

APPEAL

[1] On 30 April 1999, the Special Commissioners of Income Tax ('the

Special Commissioners') delivered a deciding order to the effect that the computations by the appellant, the Director General of Inland Revenue ('the Revenue') were wrong and so revised the Revenue's two notices of assessment.

[2] The Revenue, being dissatisfied, requested the Special Commissioners to state a case for the opinion of the High Court.

[3] The High Court affirmed the Special Commissioners' deciding order with costs.

[4] The Revenue has now appealed to this court.

FACTUAL BACKGROUND

[5] The respondent ('the taxpayer') is a statutory body incorporated under the Johor State Enactment No 4 of 1968.

[6] The taxpayer's principal activities are to develop land for industrial, agricultural, property, mining, logging and other corporate activities.

[7] The taxpayer has two sources of income viz business and dividend.

[8] In exercise of the powers under s 127 of the Income Tax Act 1967 ('the Act'), the Minister of Finance granted to the taxpayer the following exemptions from payment of taxes:

Year of Assessment	Exemption
1980 to 1990	All income.
1991	All income except dividend income and development tax.
1992 to 1996	All income except dividend income and development tax.

(For brevity and convenience, a reference hereinafter to a section is a reference to that section in the Act).

[9] The instant appeal concerns the exemptions for only two years of assessment viz *1991* and *1992*.

[10] In 1990 and 1991, the taxpayer made gifts of money to the State Government of Johor and claimed deductions for them from the taxpayer's non-exempt dividend income.

[11] Although the Revenue had, under s 44(6), allowed the deductions claimed by the taxpayer, the Revenue had applied an apportionment formula and apportioned the deductions between the taxpayer's non-exempt dividend income and the exempt business income. Consequently, the Revenue issued two notices of assessment, both dated 20 November 1995, and raised assessments on the taxpayer as follows:

Year of Assessment	Tax payable
1991	RM2,824,507.62
1992	RM1,978,744.94

[12] As alluded to above, the Special Commissioners had on the taxpayer's appeal revised these two notices of assessment, and the High Court had affirmed the Special Commissioners' deciding order.

[13] In the instant appeal, the parties shared a common ground in raising three questions for determination viz the meaning of the word 'income', the exemption and the apportionment formula.

MEANING OF 'INCOME' UNDER S 127(5)

[14] The first question is whether the word 'income' in s 127(5) means gross income or chargeable income. The second question is whether the exemptions of payment of income tax are to be given at the gross income level or the chargeable income level. These two questions may be conveniently considered together.

[15] The Revenue's learned legal officer, Ms Hazlina bt Hussain (assisted by Mr Mohd Harris bin Hanapi and Ms Zaleha bt Adam) submitted that the word 'income' means chargeable income and not gross income, based on:

(1) *MCI Society Ltd v Ketua Pengarah Hasil Dalam Negeri* (1995) MSTC 2272;

(2) *Ketua Pengarah Hasil Dalam Negeri v MCI Society Ltd* (2000) MSTC 3792 (CA); and

(3) *Lower Perak Co-operative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri* [1994] 2 MLJ 713 (SC).

[16] Learned counsel Mr Md Ali bin Zaitun (Mr Kunasegaran with him) responded for the taxpayer that the word 'income' means gross income, and contended that in *MCI Society*, the relevant judgments were silent on the meaning of the word 'income', while *Lower Perak Co-operative Society*, is distinguishable, as co-operative societies have to seek exemption under para 6

of the Schedule to the Act, while the exemption granted in favour of the taxpayer in the instant appeal is as of right.

[17] My analysis of the relevant factual background reveals that for the years of assessment *1991* and *1992*, the exemption did not include dividend income.

[18] Section 127(5) allows any income which is exempt from tax by virtue of s 127, such as business income in the instant appeal, to be disregarded for the purposes of the Act. It reads as follows:

> (5) Any income which is exempt from tax by virtue of this section shall be disregarded for the purposes of this Act: Provided that —
>
> (a) (not relevant); and
>
> (b) (not relevant).

[19] Section 2(2) makes a general reference to 'income' in the following words:

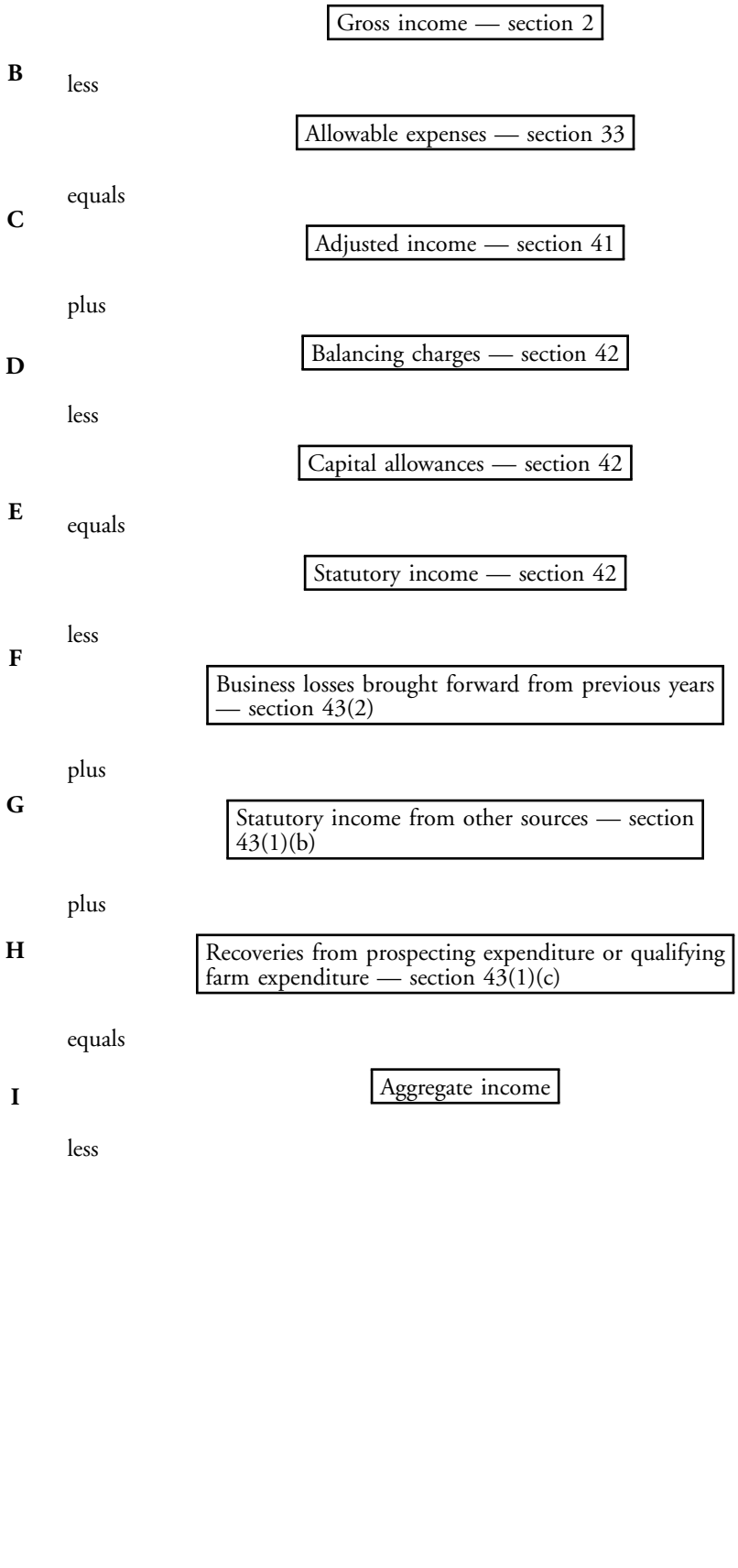
> (2) Any reference in this Act to income shall, if the income is not described as being income of a particular kind, be construed as a reference to income generally or to gross, adjusted, statutory, aggregate, total or chargeable income as the context and circumstances may require.

[20] The general reference to the word 'income' in s 2(2) is highly volatile, as the precise meaning of the word 'income' is to be dictated by reference to the context and circumstances. 'It is a word difficult and perhaps impossible to define in a precise general formula.': VS Sundaram's *Law of Income Tax in India*, (12th Ed Vol 1) p 570, applied in *MCI Society*, by the Special Commissioners who added that 'It has different meanings in the different sections of the Act.'

[21] Section 5 helps to illuminate the meaning of the word 'income' to a great extent, by setting out the various types of income, for the purpose of ascertaining chargeable income. The 'Graphic representation of the system' of ascertaining the 'Total Income from a Business' at p 275 of Dr Arjunan Subramaniam's *Malaysian Taxation System 2003* is comprehensive and merits reproduction as follows:

A Total Income from a Business

Graphic representation of the system



* Adjusted business loss for the current year — section 44(2) *Mining expenditure — Schedule 4 *Farm expenditure — Schedule 4A *Pre-operational business expenditure — Schedule 4B or 4C, loss * Approved donations — sections 44(6), 44(6A), 44(8), (9), (10), (11)

equals

Total Income

less

Personal reliefs (for a resident individual) sections 46 to 49

equals

Chargeable income — section 45

[22] This graphic representation shows that gross income and chargeable income are polarised. Consequently, the meaning to be attributed to the word 'income' would affect the tax liability of the taxpayer.

[23] To be disregarded under the Act, an exemption from tax should legally be deducted or claimed from the chargeable income and not the gross income. This is because gross income per se may or may not be exigible to tax at all. When no tax is exigible, there is no question or necessity for the taxpayer to utilise or claim the exemption. In the context of s 127(5), exemption means immunity, dispensation, exclusion, freedom, relief or exoneration from tax (see *The New Oxford Thesaurus of English* 2000).

[24] It is essential to hark back to the simple and basic rule that 'income tax is a tax on income': per Lord Macnaghten in *London County Council v AG* [1901] AC 26; *Raja's Commercial College v Gian Singh & Co Ltd* [1976] 2 MLJ 41 (PC) and *Lower Perak Co-operative Housing Society Bhd*. In other words, where there is no income, there can be no liability to tax, in which case no question of exemption can ever arise. Exemption is only relevant when there is chargeable income, but not otherwise.

[25] Strong support for my view may be found in *Lower Perak Co-operative Housing Society Bhd* at p 752 where the Supreme Court, speaking through Edgar Joseph Jr SCJ (as he then was) held that a tax exemption is only given after liability to tax has been determined, as clarified in the following passage:

A Where its business dealings result in a profit which is income, liability to income tax arises, subject to the right of a co-operative society to claim exemption under para 12 of Schedule 6 for the first five years of its trading or business dealings. In other words, there must be liability to income tax first and then only the question of claiming exemption under para 12 of Schedule 6 arises.

B

[26] I therefore uphold the submission presented for the Revenue that the word 'income' means 'chargeable income' and, hence, tax exemption is given at the chargeable income level. In the circumstances, I am unable to accept the aforesaid argument advanced for the taxpayer.

C

REVENUE'S APPORTIONMENT FORMULA

[27] The third and final question is whether the Revenue's apportionment formula is lawful and applicable.

D

[28] The Revenue relied on *Ketua Pengarah Hasil Dalam Negeri v Daya Leasing Sdn Bhd* [2005] 4 MLJ 138; [2005] 2 CLJ 449 (CA), to support the submission that as the exemption does not include dividend income, it is

E necessary for the Revenue to apportion the taxpayer's chargeable income between dividend income and business income and apply the apportionment formula to the gifts of money between the non-exempt dividend income and the exempt business income.

F **[29]** The taxpayer argued that the facts in *Daya Leasing*, are different in that Daya Leasing ran two types of business namely viz leasing business and non-leasing business, but the two businesses shared common expenses like rental, staff salaries etc and as the expenses are common to both the businesses, the expenses deductible from the businesses are unidentifiable.

G

[30] I would now put in proper perspective the facts in *Daya Leasing*. The taxpayer there was engaged in giving leasing, factoring and hire purchase financing facilities. There were expenses and interest payments on loans from the taxpayer's holding company common to both the leasing and non-leasing

H businesses which required apportionment between the two sources. The taxpayer was unable to specifically attribute the exact amount of the common expenses to the respective leasing and non-leasing businesses. The Revenue's formula for apportionment of the common expenses included the entire lease rentals, viz both the interest and capital elements, ignoring the capital

I element in the lease rentals. The taxpayer argued that it was only the interest element that had to be taken into account in respect of the gross income of the leasing business in line with the manner of ascertaining the gross income of the non-leasing business. The majority of the Special Commissioners upheld the Revenue's apportionment formula. However, the High Court

disagreed and held that the principal should not be taken into account for the apportionment of the common expenses in lease financing as there was no provision in the Act, or the Income Tax (Leasing) Regulations 1986, to prescribe the manner of doing so in respect of different income sources. The Revenue's appeal was allowed by the Court of Appeal. In setting aside the High Court decision, the Court of Appeal affirmed the Special Commissioners' majority view. The Court of Appeal held, inter alia, that the common expenses incurred had to be apportioned as implied in s 33(1) and so the Revenue's apportionment was in compliance with the law: per Augustine Paul JCA (now FCJ) at p 464 c–d. At p 151 (MLJ); p 463 (CLJ), the Court of Appeal provided the reasons as follows:

> Where there are two or more sources of income for a person and the expenses are identifiable and separable there will be no difficulty in ascertaining the adjusted income for each source. However, there will be instances when the expenses of two or more sources are not separable as they are common to the sources. As s 33(1) of the Act requires a deduction of the expenses of a source from the gross income of that source for the purposes of ascertaining the adjusted income of the sources the question that arises for determination is whether the section empowers the appellant to apportion the expenses. The power to apportion the expenses can be implied in s 33(1) of the Act in view of the need to ascertain the adjusted income ... If s 33(1) is to be strictly construed the appellant will be unable to identify the expenses separately where they are mixed with the result that the adjusted income of the sources cannot be ascertained. This will defeat the object of s 33(1) and bring the machinery of tax assessment to a halt. This will not happen in the interpretation of ordinary statutes as one of the salutary canons of construction in such cases is that Parliament does not act in vain. The courts lean against a construction which reduces a statute to futility. A statute must be so construed so as to make it effective and operative on the principle expressed in the maxim ut res magis valeat quam pareat (that the thing may rather have effect than be destroyed in order that the thing may be valid rather than invalid).

[31] The factual matrix in *Daya Leasing*, bears substantial similarity to the factual background in the instant appeal, particularly in relation to the two unidentifiable sources of income eg the non-exempt dividend income and the exempt business income in the instant appeal. Applying the apportionment formula in *Daya Leasing*, to the instant appeal, I am of the view that the Revenue's apportionment of the deduction for the gifts of money between the taxpayer's non-exempt dividend income and the exempt business income is justified and lawful. Under s 44(6), gifts of money are deductible from the taxpayer's aggregate income. Section 5 which sets out the requisite steps, as simplified in the 'Graphic representation', may now be narrowed down as follows:

A

Gross Income

less

Allowable Expenses

B

equals

Adjusted Income

less

C

Capital Allowances

equals

Statutory Income

D

less

Unabsorbed Business losses brought forward

E equals

Aggregate Income

less

F

Approved business donations and current business losses

equals

Total Incomeless

G

less

Personal reliefs (individuals)

H equals

Chargeable Income Apply Tax Rate Tax Payable

I

[32] In line with the steps set out in s 5 and the apportionment implied in s 33(1), the Revenue has produced an apportionment formula to effectively apportion the gifts of money between the non-exempt dividend income and exempt business income. For this purpose, gifts of money made to the State Government of Johor and claimed by the taxpayer as deductions under s 44(6) were apportioned accordingly. The

total amount of the gifts claimed by the taxpayer could not be allowed against only one source of income when the aggregate income of the taxpayer consists of the business income source and the dividend income source. The apportionment formula used by the Revenue is completely consistent with the approach adopted and recognised by this court in *Daya Leasing*. The answer to the third and final question is therefore in the affirmative.

CONCLUSION

[33] On the foregoing grounds, the deciding order of the Special Commissioners and the High Court judgment affirming it, are erroneous and unsustainable. Hence, this appeal is allowed with costs. The deciding order and the High Court judgment are set aside. The Revenue's apportionment formula and two notices of assessment are upheld. Deposit to be refunded to the Revenue as the appellant.

[34] My learned brothers Mohd Ghazali bin Mohd Yusoff and Vincent Ng Kim Khoay JJCA have read this judgment in draft and have expressed their agreement to make it the judgment of the court.

Appeal allowed with costs.

Reported by Ashgar Ali Ali Mohamed